



1937

Economic Conditions Governmental Finance United States Securities



New York, September, 1937

General Business Conditions

THE general volume of production and trade has been maintained at a relatively high level during August. Judging by preliminary figures, the regularly accepted indices of industrial activity will show a fair margin of gain over a year ago, notwithstanding a moderate decline from the high levels of the Spring. The Standard Statistics Company's index of industrial production, corrected for seasonal, is estimated at 99 for the month, which, though nearly 8 per cent below the year's peak in March, is still 8 per cent better than for August a year ago. Business men look forward to a good volume of trade activity in the Fall, but are conducting their affairs conservatively and there is little evidence of the boom psychology prevalent at this time a year ago.

Adjournment of Congress affords a welcome respite from legislative uncertainties, and for a few months at least business men will be able to go ahead with their plans with less fear of new forms of regulation and restriction from Washington. The failure of the bill to regulate wages and hours throughout industry to pass at the last session has brought a feeling of relief to industry everywhere. American business men, with few exceptions, are heartily in sympathy with good wages and fair working conditions for labor, as the record of industrial development in this country so strikingly shows, but they have little faith in the wisdom of governmental boards in such matters, and see in proposals of this kind only new sources of confusion and frustration. The more conservative temper displayed by the last Congress, and the improvement achieved in employer-labor relationships during the Summer, have been distinctly heartening developments. They give courage to business men to broaden and expand their activities, and unless offset by adverse developments elsewhere, tend to promote the further recovery of employment and production.

Outlook for Farm Buying Power

The most favorable factor in the business outlook is the situation in agriculture. Nature

has yielded bountiful crops, and notwithstanding the adjustment of prices to larger production, financial returns to the farm population promise to be excellent. According to figures published by the Department of Agriculture on August 22, total receipts to farmers from marketings and Government payments during the calendar year 1937 are expected to reach \$9,000,000,000, the highest since 1929 and an increase of more than a billion dollars over receipts in 1936. In making these calculations, no allowance has been made for the action of Congress in voting subsidies to cotton producers to compensate for lower prices, such subsidies to be paid next year to growers cooperating in the acreage control program. Whatever the ultimate consequences of subsidies may be, the immediate implications are bullish on the agricultural situation generally, as evidently the farmers are going to be taken care of as long as there is money in the Federal Treasury to do it.

"It is significant," says the Department of Agriculture in its report, "that farm income will be more evenly distributed over the entire nation than in any recent year. This distribution of the income is in contrast with recent years when droughts, particularly those of 1934 and 1935, sharply reduced production in many areas. Farm prices advanced as a result of droughts but this advance failed to help many farmers whose production was sharply reduced by the weather."

It is true, of course, that the figures published by the Department of Agriculture are not a measure of the farm income to be received this Fall. These figures, as has been pointed out, cover the calendar year 1937, and some of this money already has been received and presumably spent. However, on the basis of official estimates placing farm income during the first half of the year at \$3,833,000,000, the Department evidently is calculating on a farm return for the second half of the year of around \$5,167,000,000, which would be approximately \$600,000,000, or 13 per cent, greater than was received in the corresponding period of last

year. For the month of July alone, figures just published by the Department show farm marketings equal to \$740,000,000, an increase of \$30,000,000 over the total of July, 1936, and the largest for any month since May, 1930.

Moreover, as the Department goes on to say, the full significance of the increased crop production in 1937 will not be reflected in the cash income from farm marketings during the calendar year 1937 only. A portion of many of the important crops, such as wheat, corn, cotton, citrus fruits and tobacco, will not be marketed until 1938 and the larger output this year will tend to increase income in the first half of 1938 over that of 1937. The larger feed grain and hay crops, which are chiefly marketed through livestock and livestock products also will be reflected to a larger extent in the income received by farmers in 1938.

The crops mean new wealth, and prosperity in the farm areas on the basis of plenty instead of scarcity. Provided the products the farmer buys are not advanced too rapidly in price, the farmer gains and has his purchasing power increased, and the urban worker also gains—through the lower cost of food. This is a far sounder foundation for business than the distribution of hundreds of millions of dollars in a soldiers' bonus, widely acclaimed as a business stimulant a year ago. The latter is only a distribution of money and adds nothing to the sum total of wealth except insofar as it may create a demand for unutilized capacity and thus lead to new production.

The Situation in Trade

With the farm outlook as described, it might be supposed that the markets would be moving forward enthusiastically, whereas, actually, speculative interest has been slack and prices on the Stock Exchange have declined, more, however, from lack of demand than from any important volume of selling. Apparently, the business community has been more impressed with the continuing uncertainties, political and otherwise, including the possible repercussions of the tragic conflict in the Far East; and undeniably trade reports have not been up to expectations in a good many lines.

For the first ten days of August, New York City department store sales were up 2.2 per cent over a year ago, according to Federal Reserve reports, or substantially less than the average price increase. Chain store and mail order houses apparently have done better throughout the country than the department stores, but have had smaller gains than earlier in the year. In making these comparisons, it must be remembered that last year's figures, which included bonus spending, were hard to beat. Moreover, all reports indicate that vacation expenditures have been unusually heavy this year, which may have affected retail sales to some extent.

With basic raw material prices displaying an easier tendency, incentive to forward buying has been lacking, and retailers are taking their time about making commitments. As a consequence, Fall wholesale trade lagged. Meantime, progress has been made all along the line in reducing inventories built up this Spring, which suggests that if Fall retail trade opens up encouragingly there may be a rush for deliveries.

Manufacturers' Order Books Reduced

General manufacturing activity has been maintained on a high plane during the Summer, supported mainly by generous backlogs of unfilled orders, new commitments in many instances having fallen below shipments. What appears to have happened is that fear of price advances and labor troubles this Spring led to considerable advance buying and accumulation of stocks, thus requiring a period of digestion before business could go ahead.

Production of iron and steel has held up well, mills at the close of August operating at 84 per cent of capacity. Some improvement in buying was noted during the month, though not enough to raise incoming business to the level of shipments. Among principal consuming lines, farm-implement makers are booked to capacity; there is a good demand for oil-drilling and storage equipment, and can manufacturers have bought heavily of tin plate in anticipation of a big vegetable pack. Business from the railroads and from the building industry, on the other hand, has been slack. Of course, this is not the season for railroad buying, but the recent unfavorable turn of railway earnings, coupled with wage increases already granted or under discussion, lends especial significance to slow business from that quarter. Prices of iron and steel products continue firm, though talk of any further advance has disappeared, and producers of pig iron have followed the lead of steel makers in extending third quarter prices into the fourth quarter. Scrap prices rose further during the month.

Contract awards for residential construction have been disappointing this Summer; the total for July was only 12 per cent above that for July, last year, while figures for the first two weeks of August fell slightly below those a year ago. All reports indicate that rapidly mounting costs have been the principal retarding influence. Factory, commercial and utility construction, on the other hand, has continued to make a good showing, rising 80 per cent over a year ago in July, and apparently making another good gain in the first half of August. A favorable feature of the building figures is the increasing proportion of private, as compared with, public construction. For the first 7½ months of this year contracts for private building gained 50 per cent over a year ago, as against a drop of 12 per cent

in public building, although the latter was still slightly more than half of the total.

A considerable increase in steel demand is looked for next month as automobile manufacturers swing into production of new models. At present, automobile output is declining for seasonal reasons, but retail sales have been good, and production for the third quarter is expected to be well ahead of that of the third quarter last year. Reflecting increased wages and other costs, leading motor car manufacturers have increased prices \$15 to \$60 per car, while instalment finance companies have taken steps to tighten up credit terms in the interest of sounder conditions in the industry,—both measures possibly tending to increase sales resistance; hence trend of car sales will be watched with unusual interest this Fall. With tire inventories 50 per cent greater than a year ago, tire output is being curtailed and rubber consumption in July dropped 9 per cent under that of July last year.

In the so-called lighter industries, including textiles, shoes and similar consumer goods, the tendency is towards lower production schedules unless new buying develops in volume in the near future. These industries have all been operating at high levels for two years or more, but owing to the falling off in replacement orders the quantity of unfilled business has been declining steadily since April. The slump in cotton prices has unsettled cotton goods, forcing mills to mark down their prices, notwithstanding which yarn and cloth buyers are holding off until the Government's policy with respect to loans and subsidies is made known and raw cotton values stabilized. Mill sales continue much below production.

Similarly, the woolen and shoe industries, while not disturbed by unsettlement in the price structure of their raw commodities since both wool and hides continue in a relatively strong position, are faced with the necessity of curtailing operations and several mills have slowed down, rather than build up stocks. Some shoe factories are now operating only three days a week until heavy stocks of leather and shoes can be worked down. Shoe production has broken all previous records for the past two and a half years, so that some let-down for the second half would not be surprising.

Income, Prices and Purchasing Power

Notwithstanding the uncertainties referred to above, it is evident that present business and employment conditions are highly satisfactory as compared with what they have been in any year since 1929. The explanation for this recovery is simple and carries the key to the future,—correction of the abnormal price disparities of the depression, thus permitting

the restoration of the exchange of goods and services between the various groups that compose the economic system.

While prices and living costs have undergone advances during the past year, it does not appear that the rise has been out of line with the increase in national income. According to the National Industrial Conference Board, the cost of living index for July stood at 88.9 (1923 = 100) compared with 85.2 for July, 1936, an increase of about 4 per cent. Similarly, a cost of living index for Massachusetts, compiled by the State Labor Department, showed for July, 1937, a rise of 3½ per cent over July last year, shelter costs rising 6.2 per cent, food 5.4 and clothing 4.3 per cent, fuel and light dropped 2.5 per cent and sundries were unchanged.

According to the Fairchild index, average prices in department stores are up about 10 per cent over a year ago, while mail order prices in the Fall and Winter catalogues are up about 5 per cent.

Against these increases in prices and costs, farm income is up more than 10 per cent and an index of factory payrolls stood in July (latest month available) at 101.2, compared with July last year at 80.2, an increase of 26 per cent.

The point of all this is that, notwithstanding the rise of prices, incomes of farmers and wage earners apparently have more than kept pace, which would seem to indicate continued good buying power on the part of large masses of the population. Of course, incomes of many people of the professional and white collar class doubtless have not increased so much, and fixed income not at all. These have to be taken into consideration. In building, where costs have increased sharply in the year, expansion has been held back, emphasizing the need of keeping the price structure in balance,—a need made all the more imperative if the Government carries out its budgeted reduction in the deficit during the current fiscal year, for industry must then be self-supporting.

Indications are that the rise of prices, even in the building field, has been checked for the time being at least. This is a favorable symptom and should reduce labor unrest.

And, finally, it would be appropriate to refer to the general improvement in world conditions as giving support to our situation. According to a statement of the U. S. Department of Agriculture, world industrial output during the first six months of this year reached the highest level in history, exceeding the previous peak made in 1929. Not only has production increased, but the volume of world trade, while slow to recover at first, has risen to within 10 per cent of 1929 figures, according to statistics of the League of Nations.

Money and Banking

In August, six of the regional Federal Reserve Banks, to wit—Chicago and Atlanta, Minneapolis, New York, Richmond and Dallas,—reduced rediscountrates, in the order named. Cuts were from 2 to $1\frac{1}{2}$ per cent, except at New York where a $1\frac{1}{2}$ per cent rate already in effect was reduced to 1 per cent. On the new basis, rates at these banks are the lowest in the history of the Federal Reserve System, while the 1 per cent rate at New York is understood to be the lowest on record for any central bank.

The new Federal Reserve rates compare with central bank rates in effect in foreign countries as follows:

Rediscountrates of Central Banks

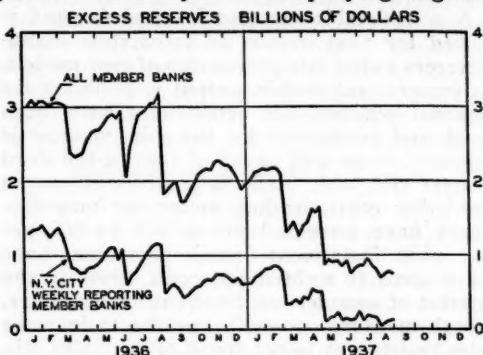
Country	Rate %	Country	Rate %
U. S. (New York)..	1	Czechoslovakia	3
Switzerland	$1\frac{1}{2}$	Japan	3.29
England	2	Argentina	$3\frac{1}{2}$
Belgium	2	Austria	$3\frac{1}{2}$
Holland	2	Denmark	4
Canada	$2\frac{1}{4}$	France	4
Sweden	$2\frac{1}{2}$	Norway	4

Action on rediscountrates comes at a time when the volume of rediscounts stands at negligible figures. On August 25 total rediscounts of the System amounted to only \$19,000,000, of which \$12,000,000 was in the New York bank. Chicago, one of the first of the Reserve Banks to cut the rate, showed borrowings of only \$40,000 in the week prior to the announcement. As explained in a lengthy statement by the Board of Governors of the Reserve System, the action taken was pointed towards the Fall when considerable seasonal increase in the demand for currency and credit is anticipated. The Reserve authorities hope by this move to encourage member banks to obtain funds for seasonal needs by rediscounting rather than by liquidating their security portfolios, with consequent repercussions in the bond market. The Board's statement reads in part:

The Board's approval (of rate reductions at Chicago and Atlanta) was based upon the view that the reduction of discount rates at this time would assist in carrying out the system's policy of monetary ease and make Federal Reserve Bank credit readily available to member banks for the accommodation of commerce, business and agriculture, without encouraging member banks to borrow outside of their own districts or to liquidate their portfolios in order to be in a position to meet the needs of present or prospective borrowers.

As the Board's statement goes on to explain, rediscountrates had little practical significance during the period when excess reserves were ranging between \$2,000,000,000 and \$3,000,000,000, for then there was scarcely any occasion for the member banks to borrow. During the past year, however, the position of member banks has changed considerably. With the carrying out of the policy of raising reserve requirements, excess reserves have been reduced below \$800,000,000 for the member bank system as a whole, and to around \$100,000,000 for the New York City member banks alone.

The movement of excess reserves over this period is shown by the accompanying diagram.



While excess reserves of this magnitude have proved ample during the Summer months, there has been a question as to whether, without some replenishment, they would be fully adequate to finance seasonal expansion this Fall. Last year currency in circulation increased about \$275,000,000 between the middle of August and the first of December, with a further rise of \$200,000,000 thereafter to the Christmas peak. Allowing that part of the seasonal currency increase will be supplied this year, as last, with silver certificates issued by the Treasury against silver purchased, the indications nevertheless have been,—taking account both of the expanding commercial loans and of the uneven distribution of reserves,—that many banks may be faced before the end of the year with the alternative of either borrowing or disposing of a portion of their investments.

It is with a view to facilitating member bank borrowing and avoiding the dumping of securities that the Reserve Banks have acted. To what extent the commercial banks will avail themselves of the low rediscountrate privileges is impossible to say. Probably banks which are carrying very short Treasury paper, some of it yielding less than $\frac{1}{2}$ of one per cent, will prefer to let such paper run off, since this would appear to be the natural and logical thing to do. On the other hand, banks whose investments are principally in the longer-term, higher yield paper may prefer to rediscountrate rather than to sell, particularly in instances where the sale of securities would involve taking a loss.

It should not be amiss to point out at this juncture that concern over the Government bond situation would not arise were the Federal budget in order and the Treasury accumulating a surplus with which to reduce the sum total of its outstanding obligations. With interest rates now standing at practically the lowest levels on record, there is questionable wisdom in attempting to hold them down in the face of an expanding demand for credit. Moreover, it must be clear that we cannot go on indefinitely supporting Federal credit with cheap

money when the key to the situation really lies in a balanced budget.

Money Rates and Bank Credit

Money rates generally showed little response to the lowering of rediscount rates, though an undertone of firmness was evidenced by the sensitive Treasury bill rates which advanced from a low during the month of 0.459 per cent to 0.615 per cent for 273-day maturities. Open market rates for commercial paper ranged 1 to 1½ per cent, with supplies increasing; total paper outstanding at the end of July, as reported to the Federal Reserve Bank, was \$325,000,000, an increase of \$137,100,000 over the July, 1936, figure, and the largest for any July figure since 1930. Bankers acceptances outstanding at the end of July were \$351,556,950, a decline of \$12,646,893 from the end of June, but an increase of \$36,082,510 above July, a year ago.

Should interest rates tighten appreciably, one source of relief to the money market doubtless would be the sale of acceptances to the Reserve Banks. With the latter's buying rate ½ of one per cent for endorsed bills up to 90 days, it would not take much of an advance to put open market rates (now ½ bid, 7/16 asked, for bills up to 90 days, unendorsed) in line, thus attracting bills to the Reserve Bank and adding to member bank excess reserves.

At the commercial banks, the feature continues to be the shifting of assets from investments to loans. With the banks that report weekly, commercial, industrial and agricultural loans increased \$181,000,000 during the four weeks ended August 25 to a new high point for the year. At the same time, these banks sold or permitted to mature without replacement approximately \$100,000,000 of Government securities, direct and fully guaranteed, and \$37,000,000 of other securities, reducing combined investment portfolios to a new low since 1935, off nearly \$1,400,000,000 since July, a year ago. On balance, total loans and investments showed little change for the month, while deposits declined, reaching a new low for the year.

Gold Stock at New Peak

Gold reserves of the United States continued to increase, and both the total gold stock and the "sterilized" gold fund reached new high levels, the former at \$12,541,000,000, and the latter at \$1,300,000,000. Of total gold imports of \$87,000,000, exclusive of changes in earmarked stocks, during the first 28 days of the month, \$45,000,000 came from Japan, and the balance chiefly from Canada and Australia. The movement from London, which was a major factor in the rapid increase of our gold stock during the first part of the year, has dwindled to small proportions with the virtual cessation of the flow of gold from private

hoards. What gold is now coming to the London market—chiefly newly-mined metal—is apparently being taken by the British Government.

The bond market has been reactionary during the month. Notwithstanding the lowering of rediscount rates, Government bonds have been under pressure, investors evidently being more impressed by the official intimations of increased credit demands to come than by the prospect of interest rates remaining unaffected. Second grade corporate issues tended to decline with the stock market, with second grade rails particularly weak, on poor earnings reports and higher wage costs. In the foreign group, Japanese issues declined sharply, recovering partially towards the close. The following table, compiled from Moody's averages of bond yields, indicates changes in average yields of various groups of bonds during the month, and as compared with high and low yields of the year.

Moody's Index of High Grade Bond Yields—1937

Group and Rating	Aug. 26	July 31	High	Low
8 U. S. Government.....	2.46	2.35	2.61	2.04
Corporate				
10 Railroad Aaa	3.54	3.52	3.69	3.29
10 " Eaa	5.90	5.84	5.92	4.97
10 Public Utility Aaa.....	3.21	3.20	3.39	3.05
10 " Baa.....	5.05	5.05	5.30	4.47
10 Industrial Aaa	3.07	2.99	3.35	2.86
10 " Baa	4.12	4.14	4.26	3.92
Foreign				
10 Foreign Govt. A	5.10	5.11	5.36	5.09
10 " Ba	8.40	7.88	8.40	7.53

The Agricultural Situation

Crop reports during August have continued generally favorable. Expectations as to crop yields have been running high since the beginning of the season, and with cotton and corn now almost out of the danger zone it is practically certain that the harvests of all the chief crops will be above average, for the first time in four years. The indicated yield of cotton, going by the Government's August 1 estimate, is the largest ever recorded, 223.3 lbs. per acre, for a total of 15,593,000 bales. The previous high yield, 216.4 lbs., was made in 1914, before the boll weevil had made much progress in its spread across the Belt from the Mexican border. Prophecies of disaster to American cotton growing, based on the boll weevil, erosion and soil exhaustion, were common a few years ago, and recognition should be given to the work of the agricultural scientists, governments, and many private interests in evolving methods of weevil control, soil conservation and improved cultural practices, which in a year of favorable growing conditions have made a record-breaking yield again possible.

The corn yield per acre is 27.7 bushels, the highest since 1923, and the wheat yield the best since 1932. The corn crop is estimated at

2,659,000,000 bushels, more than 1,100,000,000 larger than a year ago. All the feed crops are good. The August 1 wheat estimate was 890,000,000, which is 8,000,000 larger than the July 1 figure; and this estimate is practically final, subject to correction for threshing returns.

The Cotton Situation

Except for 1931 the cotton growers have not had to market a crop as large as this year's since 1926. In that year the crop was 17,977,000 bales, and the price dropped from an average of 20.53 cents in the preceding season to a low of 12.15 cents in December. At the lower price buying from all the markets of the world converged on the United States; exports for the season rose to 10,926,000 bales, compared with 8,051,000 the previous season, and domestic consumption increased from 6,176,000 to 6,880,000, with the result that the crop was readily absorbed, and during the following Summer the price recovered to 23.90 cents.

It was formerly the custom of many foreign spinners to buy two years' supply of American cotton, or more, in years of large crops, these reserves constituting a form of "ever-normal granary" and "stabilizing" the market just as much as any other kind of buying and storing would stabilize it. However, in the season mentioned, and in most other seasons prior to the A.A.A., American cotton had but minor competition in the world markets. Foreign cotton crops totaled only 9,808,000 bales in 1926-27, but this season they will evidently total 19½ million or more, and from 8,000,000 bales or more each season our exports dropped last year to 5,500,000.

All authorities agree that the 12 and 10-cent loans to growers on cotton made in the 1933-34 and 1934-35 seasons, which pegged the price of American cotton well above what foreign growers would sell for, were chiefly responsible for the doubling of foreign cotton production in six years, and for the loss of the export market which American growers need this year. However, another price-pegging loan is to be made this season, at 9 cents, with an additional 3 cents paid to growers who subscribe to next season's soil conservation plan. Thus the "losses" of the cotton growers attributable to previous Government policies will again be assumed by the Government, in the hope that another succession of poor crops will right the price situation again.

The Grain Markets

Wheat growers are more fortunate than cotton growers, for they have higher prices as well as a larger crop, and the world needs our surplus wheat. The crop is around 200 million bushels in excess of our consumption requirements, even allowing for heavy feeding of low quality wheat to livestock, prior to the arrival of new corn in late October. This surplus will

be needed, however, not only to replenish our 91,000,000 bushel carryover, lowest in many years and comparing with 378,000,000 bushels four years ago, but to supply European importing countries. Although early export business has been slow, there evidently will be a good demand for our wheat abroad; and we will have available for export 120,000,000 bushels of the qualities desired by European countries. Canada's crop is expected to be only 165,000,000 bushels, smallest since 1914, leaving her only about 65,000,000 for export, which is 150,000,000 less than she exported last year. Present prospects indicate a European crop about 50,000,000 bushels larger than last year, but Southern Hemisphere crops in Argentina and Australia together next Winter, on the basis of early weather conditions, may be smaller by a like amount. Thus Europe's demand for Northern Hemisphere wheat may be about the same as last year, barring any unusual exports from Russia where prospects are for a larger crop. The world wheat outlook is strong for another year; the carryover on July 31 was reduced to about 525,000,000 bushels from 760,000,000 a year ago, smallest since the World War. This drop entirely offsets the larger crops.

Profitable Feeding Again

After a year of feed scarcity, despite the heaviest corn imports from Argentina on record, livestock feeding promises to be profitable once more. With good crops of all feed grains expected and live-stock numbers on farms greatly reduced, feeders will have available as much grain per animal as in any of the past dozen years, and still be able to rebuild their extremely low farm stocks. In July top prices for hogs reached \$13.90 in Chicago, the highest since 1926. With a good consumer demand for meats, they should remain relatively high for some time, although the usual seasonal decline is expected late this Fall. Hog slaughter has been extremely light since May, and in July was the smallest since 1896. Moreover, the seasonal increase from October through December, when Spring pigs begin to reach market, is expected to be less than usual due to delayed marketings in order to feed hogs to heavy weights and the large numbers of sows which will be withheld for breeding. In the meantime the heavy storage stocks of pork and lard, accumulated from forced slaughter early this year as corn became scarce, are declining sharply.

Cattle prices have moved sharply and consistently upward during the past year. With a very small slaughter in July, top prices in Chicago for well-finished grain-fed cattle reached \$18.00 late in August, the highest since 1928. The favorable feeding prospects have created a strong demand for stocker and feeder cattle with the result that the usual Fall sea-

sonal decline in prices of the lower grades of slaughter cattle may not occur at all this year. Prices of the better grades of slaughter cattle are also expected to remain near present high levels. The number of cattle on feed on August 1 was 29 per cent below a year ago and the smallest in many years.

Record Excess of Imports

The disclosure that our foreign trade for the first six months of 1937 resulted in an excess of imports of \$147,000,000 has been subject to various interpretations, among them that the United States is finally beginning to reflect in its trade balance the logical consequences of its creditor position.

Close scrutiny of the trade figures, while revealing many significant tendencies, indicates bases for skepticism as to the permanence of the import surplus, many factors of which are temporary and seem likely to change over the coming months. In the first place, our purchases of crude industrial materials, which now form about one-third of our total imports, have been exceptionally heavy, partly because of our industrial activity and partly because of the building up of supplies. The latest tendency points to the working off of raw material inventories in several large industries and consequently small imports of raw materials in the second half of this year.

Moreover, the fact that the price of our imports has risen faster this year than the price of our exports accounted for \$80,000,000 of our import excess in the first six months. According to the Chief of the Foreign Trade Statistics Division in the Commerce Reports, E. A. Tupper, "a gain of 8 per cent in the average unit value (price) of exports accounted for \$114,000,000 of the \$372,000,000 increase in the value of exports, while a gain of 13 per cent in the average unit value (price) of imports was responsible for \$194,000,000 of the \$471,000,000 increase in the value of general imports as compared with the first half of 1936". Notwithstanding this advance in import prices, we are still buying our imports about 30 per cent cheaper than in 1929, whereas we sell our exports at only 18 per cent less.

Growth of Capital Goods Exports

At no time in the past have our exports consisted of such a large proportion of industrial semi-manufactures and finished goods. At \$1,093,000,000 in the first six months of 1937 against \$766,000,000 last year, the industrial exports accounted for 73 per cent of our total trade; in 1926-30 the percentage was around 60 and in 1910-14 about 46. We have failed to recover the ground lost in exports of our industrial consumption goods, such as textiles, leather and rubber goods, chiefly because the proficiency of new industrial nations in manufacturing and even exporting these goods has

curtailed the market for this type of our exports. At the same time, however, the new industrial nations have not been able to satisfy higher living standards at home wholly from their own resources. Consequently, new markets for capital goods have been opened up which promise to more than offset our losses in the export of consumption goods. The wide gains in our capital goods exports this year—ranging from steel ingots and unfabricated plate to specialized machinery, automobiles, electrical apparatus and industrial chemicals—are shown in the table below and emphasizes that the spread of industrialization tends to increase rather than decrease international trade.

U. S. Exports of Manufactures by Important Groups (In Millions of Dollars)

	6 Months Ending June				% Change
	1929	1932	1936	1937	From 1932
Total Exports	2,579	820	1,135	1,507	+ 84
Machinery	301	72	164	226	+214
Automobiles	340	46	133	176	+233
Iron & Steel Products	184	27	72	153	+467
Copper & Mfts.	102	13	22	48	+269
Chemicals	43	24	35	45	+ 88
Cotton Cloth & Mfts...	117	41	34	43	+ 5
Rubber & Mfts.	41	9	12	16	+ 77
Petroleum & Products	273	116	126	170	+ 47

The Shifts in Agricultural Exports and Imports

Had it not been for the severe drought in 1936, our imports during the first half of 1937 would have been smaller by another \$80 - 100,000,000; we spent this amount for purchases of foreign wheat, fodder grains, cottonseed oil, meats and other agricultural products of which we normally have a surplus. For the first time in our history we imported more pork than we exported. The drought also reduced our agricultural exports, already scaled down by our crop curtailing policies and a greater self-sufficiency on the Continent in Europe. Our total agricultural exports, including cotton, contributed in the first six months of 1937 only about 21 per cent of our total exports, compared with 35 per cent in 1929 and 50 per cent before the War. In volume, agricultural exports in June established a low record for the entire post-war period.

The bright crop outlook, with the prospects of good demand for some of our agricultural products abroad, and lessened need for import, will undoubtedly result in a shift in our foreign trade this coming Fall and Winter. The change in the wheat situation, alone calculated at the present prices and available quantity, will make a substantial difference in the total.

The World Steel Boom

We are in the midst of the greatest peace-time boom ever experienced by the world's iron and steel industries. If the current rate of activity continues, the world steel mills this year may turn out 140,000,000 tons of steel, which would exceed the previous peak outputs of around 120,000,000 tons each in 1929 and

1936 and dwarf the pre-war output, which during the 1909-13 period averaged only about 68,000,000 tons.

The economic and political developments in the past five years have greatly changed the outlook, not only for steel itself but also for the raw materials used in its making. In 1932 the world steel industry, except in the Soviet Union and still younger nations, was burdened by what was believed to be a huge excess capacity, and steel scrap was a drug on the market. Today the output is almost 200 per cent above that of 1932; steel scrap is selling four times as high as in 1932 and is regarded as a valuable national resource, the export of which is prohibited by a number of nations. The problem of excess-capacity has disappeared, at least for the present.

Evidences of demand outstripping supply are numerous. Several nations are rationing pig iron and steel among their industries; other countries are regulating exports of steel products to protect their industries from a too rapid price-rise at home.

Causes of the Boom

The primary cause of this outburst of activity is the fact that there has been little expansion of steel-making capacity during the depression years, and meantime the demand for new and improved industrial equipment has greatly increased. The higher wage-scales in all countries have offered more inducements to more economical utilization of man-power. Every industry affords examples of this kind, and wherever one is a demonstrated success competitive pressure compels its general adoption. Shipbuilding is an example of such replacements. In Great Britain this is now at the highest point in six years and in Japan more than 150 ships are under construction. The modernization of railroads and highways is bringing business to steel mills in many European countries. The scarce demand for war equipment has been an important factor, but it has crowded out or delayed a large volume of industrial business, by taking precedence or by raising prices.

World industrialization has furnished a constantly widening demand for steel and iron products. Industrialization embraces machine production, mechanization of transportation facilities and the harnessing of energy; in brief, the entire mechanical progress stimulated by the last War and so inseparably associated with the rise in the standard of living. The rapid growth of the demand for iron (first of the foundry types, now mostly in the form of steel) illustrates how essential this metal has been to the world's mechanical progress. Since 1870, world consumption of iron and steel has increased tenfold and has doubled in the last generation. This is conclusive proof of

the increase in productive capacity for supplying all human wants, and, of the rising standard of living over the world. In this country we are estimated to be using at the present time about one billion tons of steel, chiefly in productive equipment of various kinds; another billion tons is probably in use in Europe, and with the Far East and South America becoming steel-conscious the demand for steel must expand in the future. Last year Argentina and Brazil imported about 1,300,000 tons of steel products. In China, industrialization has made remarkable progress during the last two years. Several thousand miles of new highways and railroads have tapped new regions and created new opportunities for industry and trade outside of the coastal areas. The industrial revolution, inaugurated by the steam engine 150 years ago, has lost none of its vitality.

Steel Scrap and the Spread of the Industry

With the expanding use of steel, the industry itself began to spread all over the world. The pace was much slower than, for example, in the textile industry, for the simple reason that steel making requires much more capital as well as locations near both ample deposits of easily worked iron ore and cheap supplies of fuel and mechanical energy.

However, modern metallurgical and technological developments have begun to free the iron and steel industry from concentration in areas where these restrictions exist. First, the open-hearth process widened the range of usable iron ores both in respect to content and associated minerals, and more recently the electric furnace has made hydro-electric power available for steel-making in the countries lacking sufficient coal. The employment of iron and steel scrap in steel-making is a simplified process requiring much less fuel. Since scrap is widely distributed all over the world, nations with cheap transportation facilities and a domestic market may readily "mine" it and build up their own steel industries. This has given greater flexibility and mobility to the industry, and stimulated new competition.

The utilization of scrap was stimulated by high steel prices during the war. Its collection became an important industry, giving livelihood in this country, it is said, to 250,000 workers. Economically it is of great value in prolonging the life of all existing ore deposits, for present iron stocks will be worked over indefinitely, although they must be reinforced by virgin supplies. The competition has prompted the mechanization of ore-extraction, whereby an increase of 40 per cent in the man-output has been achieved in the post-war period. Thus both from the viewpoint of conserving natural resources and of stabilizing prices, the use of scrap has been one of the most important developments of modern industrial technique.

Until the outbreak of the War, the world output of pig iron was usually somewhat larger than the output of steel, the balance being used for the making of foundry and malleable iron. Since the War, however, this relationship has completely changed. It is estimated that in the last five years approximately 45 per cent of the world steel output has come from iron and steel scrap.

The steel industry is no longer concentrated in Western Europe and North America. It has spread eastward, into Asia, which in 1936

Growth of Steel Production 1929 to 1936
(In thousands of metric tons)

	1929	1936	(In % of 1929)
Older Countries:			
United States	57,339	48,534	85
Germany & Saar	18,233	19,158	105
Great Britain	9,791	11,885	121
France	9,716	6,703	69
Belgium & Luxemburg..	6,812	5,156	76
Sweden	694	977	141
Austria & Czechoslovakia	2,837	1,984	70
 Newer Countries:	 105,422	 94,898	 90
Soviet Union	5,003	16,244	325
Japan	2,343	5,150	220
Italy	2,122	2,025	95
British India†	1,418	1,565*	110
Canada	1,400	1,132	80
Poland	1,377	1,145	83
Manchukuo & Korea†....	450	824*	188
Danubian Countries‡	773	903	117
Mexico & Brazil	145	180*	124
Australia & So. Africa†	500	950*	190
 Grand Total	 15,531	 30,118	 194
	120,953	124,516	103

Note: The countries showing declines from 1929 were still suffering from the depression in 1936 and most of the others were not operating at full capacity.

*Partly estimated. †Pig iron output. ‡Yugoslavia, Roumania and Hungary.

Source: League of Nations reports; Statistics of various countries.

made 80 per cent more steel than in 1929, exclusive of the new steel centers in Siberia. Nationalistic efforts toward self-sufficiency naturally have encouraged this tendency. In 1936, about 24 per cent of the world steel output, as shown by the accompanying table, came from the "newer countries", compared with only 13 per cent in 1929.

New Steel Centers and Steel Trade

The establishment of the new steel centers and steel processing industries outside of North America and Western Europe during and after the War, has caused many changes in the international steel trade. The machine shops and small steel mills in South Africa, Australia, Mexico, Chile, Brazil, Argentina and even China are now able, with the protection of tariffs, to supply local markets with a variety of home manufactured steel products; but as their domestic output is still far too small for their requirements they continue to import steel and iron semi-manufactures, as well as such finished products as machinery, machine tools and motor vehicles.

In India, one of the largest and most valuable iron ore deposits in the world, quite similar to the deposits in our Lake Superior region, together with a sufficient supply of coking coal, and a comparatively short distance to tide water, has provided ideal conditions for a steel center. The Jamshedpur plant of the Tata Iron and Steel Company is said to be one of the very low-cost pig iron producers of the world. India has become the second largest exporter of pig iron and although she still imports special steels, machinery and motor vehicles, the total Indian importation of steel products has shrunk considerably since 1913 or even 1929.

The Soviet Union went through a similar development even more rapidly. During the first five-year plan, 1928-32, the Union was a heavy importer of machinery and at the same time an important exporter of iron ore. By the time the second five-year plan was initiated in 1933, her new iron and steel centers in the Ural region and in Central Siberia had begun to pour out millions of tons of pig iron, rails and armaments. The Soviets then appeared as an exporter of pig iron; on the other hand, both her imports of machinery and exports of iron ore declined. In 1936, the Union, in spite of heavy armament requirements at home, became the world's leading exporter of pig iron.

In Japan and Italy the domestic steel industries have been largely dependent upon imported pig iron and scrap and the plants are mostly located on tide water. Although the Japanese industry has more than doubled since 1929, the country is planning to enlarge its capacity to 8,000,000 tons in the next few years. Japan has not only become practically self-sufficient, except for special alloy steels, machinery and tools, but has become a formidable competitor in the world steel trade. Her steel exports rose from 71,000 tons in 1931 to 528,000 tons in 1935, and, according to a 1936 report, she is now the third largest exporter of steel products to the Pacific area (China, British India, Australia, Java and Malaya), forging ahead of Germany, France and Belgium.

Perhaps the most important of the Japanese acquisitions is a deposit on Koolan Island, near deep water, for which a concession was granted by the West Australian Government to British parties, but apparently has passed to Japanese control. An American engineer has planned the development, with the latest equipment for docks, mining and handling.

As long ago as 1921 a Japanese company obtained an iron-mining concession in India, and its shipments to Japan in 1935 were reported at 595,000 tons. In 1928 the same company began operations in Malaya, and another company began nearby in 1930; their combined output for 1935 was reported at 817,000 tons. Iron ore shipments from the Philippine Is-

lands to Japan in 1936 were reported at 650,000 tons. Besides these resources the Oriental Iron Company, Ltd., with a deposit on the Island of Samar is said to have contracted to deliver 1,000,000 tons of ore in Japan annually after 1938. More recent reports tell of important acquisitions, of iron deposits in the Netherlands East Indies, and the Japanese have been working deposits in Manchukuo and China for a number of years.

A fleet of ocean carriers, subsidized by the Government, is being built to transport these ores from overseas. A great steel plant, also subsidized, is under construction near Kobe, and it is said that in 1941 the country's pig iron capacity will be about 6,000,000 tons, with more to follow. This is not much below the average British production in pre-war years. From being a nation scantily supplied with iron resources, Japan is rapidly becoming one of the best supplied and equipped.

Thus it appears that Japan has not only reached the front rank as a producer of textiles (wool, cotton, silk and rayon) but will soon reach a similar position in steel and its numerous manufactures. In other words, she is acquiring the basis for a great manufacturing nation and will soon be introducing and selling all kinds of machine tools and equipment throughout Asia, and probably elsewhere, as now with textile machinery.

Scrap Prices and Iron Ore Production

This expansion of the steel industry was stimulated during the depression years by the bargain prices of scrap and the extremely low shipping rates. For example, when the Japanese industrial recovery got under way in 1932, iron and steel scrap was selling at our seaboard below five dollars per ton, or less than one-third of the average price of steel scrap in 1929. Half empty ships were using scrap steel for ballast and moving it for handling charges only. It was cheaper to move steel scrap from New York to Japan than from New York to Pittsburgh. Soon a brisk trade sprung up, with the scrap moving from the countries with large scrap reserves, as the United States, Belgium, France and the Netherlands, to the newer industrial countries with low reserves, as Japan, Italy and Poland.

The American Iron and Steel Institute has estimated recently that the average life span of finished steel products is now about 33½ years. Hence, during the depression years the annual accumulation of iron and steel scrap in this country, based on one billion tons of steel in use, must have been theoretically around 30,000,000 tons, which exceeded our new output of steel during each of the years from 1931 to 1934. Scrap prices consequently declined sharply, the collection of scrap was relaxed and iron ore extraction was curtailed. In 1932, for example, we mined only 13 per cent

of the iron ore extracted in 1929, which on the basis of an average iron content of 50 per cent, would have sufficed for only 5,000,000 tons of steel. Similar conditions existed abroad; many iron mines were shut down in France, the world's second largest producer of iron ore, and also in North Africa, Spain, Cuba, Sweden, Austria, Chile and Newfoundland.

Iron ore prices, being governed by long term contracts, and by reason of the importance of such factors as taxes, freight-tariffs, royalties, etc. remained practically unchanged through the entire depression. The wide spread between foundry pig iron and steel scrap favored the use of the latter, hence much more of it was used in charging furnaces during the early recovery days than normally. The revival of capital goods production changed Germany and Great Britain from exporters of scrap into importers. In the United States sharp competition between the demand for export and the mill demand caused the price to rise rapidly. In July, 1932, scrap sold in Chicago as low as \$4.88 per ton, but in the Fall of 1933 it was up to \$10; in October, 1936, it was at \$16, and in the Spring of 1937 maintained the \$21.75 rate for several months. The latest quotation is \$19.75.

The failure of iron ore production to keep pace with the steel output in the 1932-36 period is shown by the accompanying table, and also the change since 1913. Even in 1936, when outside of the Soviet Union the world steel output practically recovered to the pre-depression level, the world iron ore output was only three-fourths as large. The world made in 1936 almost 50 per cent more steel than in 1913, but actually mined less iron ore. This shows the growing importance of scrap.

The Trend of World Iron and Steel Output and
U. S. Prices
(1929 = 100)

Year	World Output of				World		U. S. Prices	
	Iron Ore	Pig Iron	Steel	Trade	Pig Iron	Steel	In (Com-	In
	Without	Without	Without	With	In	Trade	Steel	Chicago
1913..	87	79	65					
1929..	100	100	100	100	100	100	100	100
1930..	87	79	77	79	73	93	81	
1931..	56	54	55	58	59	84	60	
1932..	33	35	39	42	55	76	42	
1933..	40	45	53	56	91	82	54	
1934..	51	55	63	68	134	95	68	
1935..	58	64	75	82	144	98	77	
1936..	76	82	95	103	168	103	99	
1937..	—	—	104*	114*	—	121†	129†	

*Estimate. †First six months.

Source: League of Nations, Mineral Year Books, "Iron Age". "Steel" and others.

The Scramble for Raw Materials

The rising prices of scrap turned the attention of steel makers to pig iron and iron ore of which stocks were low. Moreover, civil war had reduced the output of valuable Spanish ores, usually needed for mixing with low grade German and Lorraine-Luxemburg ores.

Thus the armament boom caught all producing countries with short supplies of raw materials.

Germany's position is unsatisfactory. She has plentiful reserves of good coking coal, but only limited deposits of iron ore, and of low grades. She is making strenuous efforts to reduce her dependence upon foreign ores, which she has been getting mostly from Sweden, the Lorraine-Luxemburg area, North Africa and lately also from the Balkans and Turkey. Despite the expanding domestic output of iron ore and painstaking collection of scrap at home, she must import more than half the raw materials needed for her large steel output. Recently the German Government has taken over by decree all the undeveloped ore deposits.

In Italy and Great Britain the pressure on scrap material has been so strong that iron fences and ornaments of public grounds have been sacrificed, and ships of low-earning capacity, including many of familiar names, have been melted down. Negotiations for the Leviathan are reported.

Production of New Iron Ore Areas
(In thousands of metric tons)

	1929	1935
Philippines	283	
Korea	559	598
Manchukuo	781	1,478
British India	2,468	2,402
British Malaya	823	1,681*
Australia	867	1,904
Sierra Leone (West Africa)		587*
Union of South Africa	38	365
*1936.	5,536	9,298

Great Britain is competing in all fields for ore, scrap and pig iron, to supplement her domestic ore output and reduced supplies from Spain. She is also developing new deposits in Sierra Leone on the West African coast. However, the chief problem facing the British is insufficient plant capacity, modernization of which was delayed after the War. To secure the highest possible output from the existing plant, last Spring the British prices were advanced to bring in marginal furnaces. The annual output has approached the record rate of 13,000,000 tons of steel (which is over 30 per cent higher than the production achieved in 1929, or at any time during the War) but a shortage of steel is still reported. The abolition of import duties on pig iron last March, and more recently the reduction of duties on semi-finished steel products, also were intended to relieve the shortage.

How the rapid recovery caught the British napping is described by a recent paragraph in the London Times, as follows:

During the War, of course, large extensions were made to this country's steelworks, and it was calculated that the output capacity of the British steel industry was increased by 50 per cent in this way. Unfortunately, in the years after the War the iron and steel industry went through a particularly lean period and owing to the failure to provide it with enough work the steel industry in this country was unable to modernize its plants through lack of money.

Plants were scrapped and not replaced, and though great efforts to recover lost ground have been made since prosperity returned to the industry the severe check the industry received after the War partly accounts for to-day's scarcity.

The Position of America

The world has been drawing mainly on our own reserves of "surface iron", steel scrap. In four years, 1933-36, we exported 7,500,000 tons of scrap, and through June this year another 2,000,000 tons, most of it to Japan. This was because scrap was quickly available material. However, the customs reports also show that this rise of prices abroad is causing a large demand for our finished steel products; more, indeed than our steel works are able to supply, the aggregate of iron and steel exports in the first six months reaching \$85,889,000.

Our iron mines are working to present capacity, and the volume of shipments from Lake Superior over the first six months of this year was practically double that of the same six months of 1936.

In conclusion, this review of steel production and discussion of its significance, was begun in the July Letter, prompted by sensational charges that the metal industries were "exploiting" the public by their monopolistic powers. The facts presented made evident that in the general rise of prices from a long depression to a state of congested demands, wages and consumption goods had risen faster and farther than steel products; also that the steel industries of the United States have invested \$650,000,000 in the last 2½ years for enlargement of their productive capacity, although but five years ago they were commonly accused of having recklessly and wastefully used profits for plant-improvements which, it was said, should have been devoted to higher wages. It should be added, that wage-rates then were the highest ever known, and 150 per cent above the pre-war level, while, as a result of new capital investments, the cost of living had increased by less than one-half that rate. Furthermore, notwithstanding the labor-saving service of new equipment, employment in the steel industry is now at a total of about 600,000 persons, the highest on record.

This record of the development of the steel industry since the outbreak of the Great War affords conclusive demonstration of the alert, energetic, intelligent, resourceful, competition which dominates the steel industries of the world, and every other important branch of the modern economic system as well.

Not one industry can be named in which the purchasing power of the lowest wage is not higher than that of the corresponding wage in any pre-war year, and the improvements in steel production have played an important part in this development, for steel is the material of all machine equipment.

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